

FACT SHEET

AB 1178 (Assemblymember Block)

Water's Edge Tax Loophole

Summary:

This bill would expand the list of companies included in the "water's edge" group to include affiliates located in an identified tax haven country. This bill will close a known loophole in corporate tax law and will require corporate taxpayers that do not have "substantial economic activity" within a listed tax haven country to pay their fair share of California taxes. The California Franchise Tax Board estimates that closure of this loophole will generate \$330 million over the next three years (\$40 million in FY 2009-10, \$130 million in FY 2010-11, and \$160 million in FY 2011-12).

Problem:

Some multinational corporations incorporate subsidiaries in tax haven countries to purposefully avoid state taxation, resulting in less General Fund dollars for education, health, and public safety programs. An example corporation may have dozens of subsidiaries located in known tax haven countries, where little or no economic activity occurs. These countries have little or no taxation on such income, and there is no other reasonable business motive for incorporating a subsidiary in these particular countries. This is permitted because, under existing law, income and apportionment factors of those affiliated entities located within a tax haven country are not included in the calculations of the parent corporation's overall California taxable income when that parent corporation makes a "water's edge" election.

Solution:

This bill will add language to the Revenue and Taxation Code to require a corporation that makes a "water's edge election" to include income obtained in tax haven countries within the overall business activity of that corporation where funds are originally sourced to California economic activities. This revision will not apply to income from genuine subsidiaries established in non-tax haven countries, and will allow corporations to petition the Franchise Tax Board for an exemption from the inclusion for income from subsidiaries located in tax haven countries where substantial economic activity or substantial economic presence can be demonstrated. This bill will further help define the jurisdictions listed as tax havens as those identified by the Organization for Economic Cooperation and development (OECD) and require the Legislative Analyst and FTB to determine whether the definition of "tax haven" should be revised.

For More Information:

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